

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Advertising Costs

Costs for advertising products and services or corporate image are expensed as incurred.

Change in Accounting for Postretirement and Postemployment Costs

Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 112 ("SFAS 112"), "Employers' Accounting for Postemployment Benefits." SFAS 112 establishes accounting standards for benefits that are provided to former or inactive employees after employment but before retirement. SFAS 112 required immediate recognition of the cumulative effect of applying the new rule to prior years. The Company restated first quarter 1993 results to recognize a postemployment benefit liability of \$251 million. The net income impact of adopting this accounting standard was \$148 million, net of a deferred income tax benefit of \$103 million. The annual periodic expense under SFAS 112 does not differ materially from expense under the prior method.

Effective January 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106 ("SFAS 106"), "Employers' Accounting for Postretirement Benefits Other than Pensions." Annual price cap decisions by the CPUC granted the Company \$100 million and \$108 million in 1994 and 1993, respectively, for partial recovery of its higher costs. However, the CPUC in October 1994 reopened a proceeding to determine if the Company should continue to recover these costs. (See "Revenues Subject to Refund" in Note I on page 56.)

The Company was unable to defer these charges under the criteria for recognizing a regulatory asset under SFAS 71. The FCC did not provide additional recovery for either new accounting standard. The CPUC did not provide the Company additional recovery for SFAS 112 and only provided partial recovery of its higher costs under SFAS 106. In addition, the Company is required to reapply for this recovery each year. Therefore, the recovery period is uncertain but exceeds the 20-year period required by accounting rules for deferral of these costs.

B. RESTRUCTURING AND CURTAILMENT CHARGES

In 1993, the Company recorded a pre-tax restructuring charge of \$977 million to recognize the incremental cost of force reductions associated with restructuring its internal business processes through 1997. This charge is to cover the incremental severance costs associated with terminating approximately 14,400 employees from 1994 through 1997. It will also cover the incremental costs of consolidating and streamlining operations and facilities to support this downsizing initiative.

D. EMPLOYEE RETIREMENT PLANS (Cont'd)

The Company's contributions to the Savings Plans are based on matching a portion of employee contributions. All matching employer contributions to the Savings Plans are made through a leveraged employee stock ownership ("LESOP") trust. Total Company contributions to these plans, including contributions allocated to participant accounts through the LESOP trust, were \$64, \$64 million and \$61 million in 1994, 1993 and 1992, respectively.

E. OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS

Substantially all retirees and their dependents are covered under the Company's plans for medical, dental and life insurance benefits. Approximately 41,000 retirees were eligible to receive these benefits as of January 1, 1994. Currently, the Company pays the full cost of retiree health benefits. However, by 1999, all employees retiring after 1990 will pay a share of the costs of medical coverage that exceeds a defined dollar medical cap. Such future cost sharing provisions have been reflected in determining the Company's postretirement benefit costs. The Company retains the right, subject to applicable legal requirements, to amend or terminate these benefits.

Effective January 1, 1993, the Company adopted SFAS 106. The standard requires that the cost of retiree benefits be recognized in the financial statements from an employee's date of hire until the employee becomes eligible for these benefits. Previously, the Company expensed these retiree benefits as they were paid. The Company is amortizing the transition obligation over 20 years. The transition obligation represents the unrecognized cost of benefits that had already been earned by retirees and active employees when the new standard was adopted.

The Company's periodic expense under SFAS 106 in 1994 and 1993, as displayed in the table below, increased from a level of \$103 million in costs in 1992 under the prior method. The Company's higher postretirement benefits costs are being partially recovered in revenues pursuant to CPUC rules. (See "Change in Accounting for Postretirement and Postemployment Costs" in Note A on page 45.)

E. OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS (Cont'd)

The components of net periodic postretirement benefit cost for 1994 and 1993 are as follows:

Postretirement Benefit Cost	1994	1993

(Dollars in millions)		
Service cost.....	\$57	\$40
Interest cost on accumulated postretirement benefit obligation.....	251	242
Actual return on plan assets.....	(17)	(79)
Net amortization and deferral.....	45	160
Curtailment due to force reduction.....	-	632
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Postretirement periodic benefit cost.....	\$336	\$995
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Pacific Bell partially funds the obligation by contributing to Voluntary Employee Benefit Association trusts. Plan assets are invested primarily in domestic and international stocks and domestic investment-grade bonds. An 8.5 percent long-term rate of return on assets is assumed in calculating postretirement benefit costs.

The funded status of the plans follows:

	December 31,	
Postretirement Benefit Obligation	1994	1993

(Dollars in millions)		
Accumulated postretirement benefit obligation*:		
Retirees.....	\$2,250	\$2,314
Eligible active employees.....	264	207
Other active employees.....	784	919
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Total accumulated postretirement benefit obligation.....	\$3,298	\$3,440
Less:		
Fair value of plan assets*.....	(860)	(786)
Transition obligation.....	(1,704)	(1,799)
Unrecognized net loss**.....	(157)	(328)
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Accrued net postretirement benefit obligation recognized in the consolidated balance sheets.....	\$ 577	\$ 527
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E. OTHER POSTRETIREMENT AND POSTEMPLOYMENT BENEFITS (Cont'd)

- * The measurement date for determining the accumulated postretirement benefit obligation and fair value of plan assets was changed to December 31, 1994, from September 30 in 1993. The fair value of plan assets as of December 31, 1993 includes contributions made during fourth quarter 1993 after the measurement date that year. Fair value of plan assets reflect an estimated allocation of the Company's portion of Pacific Telesis Group plans' assets.
- ** The unrecognized net loss is amortized over time and reflects differences between actuarial assumptions and actual experience. It also includes the impact of changes in actuarial assumptions.

The assumed discount rate used to measure the accumulated postretirement benefit obligation was 8.0 percent for 1994 and 7.5 percent for 1993. An annual increase in health care costs of 13 percent was assumed for 1995, declining ultimately to an assumed rate of 6 percent by the year 2002. Increasing the assumed health care cost trend rates by one percent each year, would increase the December 31, 1994 accumulated postretirement benefit obligation by \$424 million and increase the combined service and interest cost components of net periodic postretirement benefit cost for 1994 by \$39 million.

Effective January 1, 1993, the Company adopted SFAS 112 for accounting for postemployment benefits which required a change from cash to accrual accounting. Postemployment benefits offered by the Company include workers compensation, disability benefits, medical benefit continuation, and severance pay. These benefits are paid to former or inactive employees who terminate without retiring. A one-time, noncash charge representing prior benefits earned was recorded in 1993 which reduced earnings by \$148 million. The charge was net of a deferred income tax benefit of \$103 million. The annual periodic expense under SFAS 112 does not differ materially from expense under the prior method.

G. FINANCIAL INSTRUMENTS (CONT'D)

The fair value of long-term debt issues as of December 31, 1994 was estimated based on the net present value of future expected cash flows, which were discounted using current interest rates. The fair value as of December 31, 1993 was estimated using quotes on an exchange or interest rates available to the Company under similar terms and maturities. The carrying amounts reflect unamortized net discount.

H. RELATED PARTY TRANSACTIONS

The Company receives certain services associated with corporate functions, e.g., legal, financial, external affairs and governmental relations, human resources and corporate strategy, performed on the Company's behalf by its parent, Pacific Telesis Group. Costs incurred by Pacific Telesis Group which are attributable to the Company are charged directly to the Company. The Company is also charged for its proportionate share of other indirect costs incurred by Pacific Telesis Group. Total costs charged by Pacific Telesis Group and included in general, administrative, and other expenses were \$81 million, \$76 million and \$65 million in 1994, 1993 and 1992, respectively.

The Company provides nontelecommunications and telecommunications services including local, toll and access services to certain Pacific Telesis Group affiliated companies. Revenues recorded for these services totaled \$21 million, \$30 million and \$30 million in 1994, 1993 and 1992, respectively.

I. COMMITMENTS AND CONTINGENCIES

Broadband Network

In December 1994, the Company contracted for the purchase of up to \$2 billion of broadband network facilities which will incorporate emerging technologies. The Company is committed to purchase these facilities in 1998 if they meet certain quality and performance criteria.

Revenues Subject to Refund

In 1992, the CPUC issued a decision adopting, with modification, SFAS 106 for regulatory accounting purposes. The CPUC decision also granted the Company revenue increases for recovery of contributions to tax-advantaged funding vehicles for SFAS 106 costs. Annual price cap decisions by the CPUC granted the Company \$100 million in each of the years 1995 and 1994 for partial recovery of higher costs under SFAS 106. However, the CPUC in October 1994 reopened the proceeding to determine if the Company should continue to recover these costs. The CPUC's order held that related revenues collected after October 12, 1994 are subject to refund. Management believes these costs are appropriately included in the Company's price cap filings, but is unable to predict the outcome.

J. ADDITIONAL FINANCIAL INFORMATION

December 31

(Dollars in millions)

1994

1993

Prepaid expenses and other current assets:

Prepaid directory expenses.....	\$323	\$336
Miscellaneous prepaid expenses.....	23	23
Notes and other receivables.....	63	45
Materials and supplies.....	60	68
Current deferred income tax benefits.....	380	346
Pacific Telesis Group and subsidiaries.....	29	17
Deferred compensation trusts.....	52	-
Other.....	20	27

Total.....	\$950	\$862
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Property, plant, and equipment - net:

Land and buildings.....	\$ 2,636	\$ 2,538
Cable and conduit.....	10,566	10,251
Central office equipment.....	9,444	9,396
Furniture, equipment, and other.....	2,892	2,906
Construction in progress.....	569	569

	26,107	25,660
Less: accumulated depreciation.....	10,243	9,708

Total.....	\$15,864	\$15,952
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Deferred charges and other noncurrent assets:

Deferred charges.....	\$ 67	\$ 107
Deferred compensated absence.....	212	226
SFAS 87 pension deferral.....	430	367
Investments.....	77	79
→ Postretirement benefits prefunding.....	176	176
Other.....	1	34

Total.....	\$ 963	\$ 989
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Other accounts payable:

Pacific Telesis Group and subsidiaries.....	\$ 52	\$ 23
AT&T and subsidiaries.....	218	214
Payroll.....	43	52
Checks outstanding.....	319	177
Incentive awards payable.....	224	188
Bellcore.....	16	19
Other.....	234	205

Total.....	\$1,106	\$ 878
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J. ADDITIONAL FINANCIAL INFORMATION (Cont'd)

	December 31	
(Dollars in millions)	1994	1993
Other current liabilities:		
Taxes accrued.....	\$ -	\$ 25
Interest accrued.....	127	114
Advance billing and customers' deposits.....	286	269
Accrued compensated absence.....	281	284
Deferred regulatory liabilities (SFAS 109)....	145	120
Restructuring.....	441	274
Other.....	86	50
Total.....	\$1,366	\$1,136
Other noncurrent liabilities and deferred credits:		
Unamortized investment tax credits.....	\$ 464	\$ 526
Accrued pension cost liability.....	755	620
Deferred regulatory liabilities (SFAS 109)....	40	108
Workers' compensation.....	175	175
Restructuring.....	378	823
→SFAS 106 Liability.....	753	703
Other.....	313	303
Total.....	\$2,878	\$3,258

For the Year Ended
December 31

(Dollars in millions)	1994	1993	1992
Other revenues:			
Directory advertising.....	\$ 984	\$ 989	\$1,003
Billing and collections.....	77	79	86
Non-regulated revenue.....	232	169	112
Other.....	113	121	129
Total.....	\$1,406	\$1,358	\$1,330

Other income (expense):			
Allowance for funds used during construction.....	\$ 28	\$ 35	\$ 31
Interest income.....	5	5	103
Other.....	(30)	(54)	(52)
Total.....	\$ 3	\$ (14)	\$ 83
Advertising expense.....	\$ 66	\$ 61	\$ 56
Cash payments for:			
Interest.....	\$ 377	\$ 614	\$ 529
Income taxes.....	\$ 762	\$ 744	\$ 829

Appendix 5

SFAS-106 Costs by Basket

FAS 106 EXOGENOUS COST FILING

RESTATED PRICE CAP BASKET DISTRIBUTION

	Common Line	Traffic Sensitive	Special Access	Inter- Exchange	Bill. & Collect.	Total
OPEB costs as originally filed	13,059,000	8,326,000	3,956,000	34,000	1,633,000	27,008,000
"Big Three" expenses underlying distribution						
Total excluding Local Transport	260,330,666	78,544,301	78,859,858	682,854	32,552,340	450,970,019
Local Transport		87,429,689				87,429,689
Total	260,330,666	165,973,990	78,859,858	682,854	32,552,340	538,399,708
% Dist.	48.35%	30.83%	14.65%	0.13%	6.05%	100.00%
"Big Three" expenses, adj. for Local Transport Restructure						
Total excluding Local Transport	260,330,666	78,544,301	78,859,858	682,854	32,552,340	450,970,019
Local Transport			87,429,689			87,429,689
Total	260,330,666	78,544,301	166,289,547	682,854	32,552,340	538,399,708
% Dist.	48.35%	14.59%	30.89%	0.13%	6.05%	100.00%
OPEB costs adjusted for the Local Transport Restructure	13,059,000	3,940,000	8,342,000	34,000	1,633,000	27,008,000
Exog. Cost for recovery of lost revenue (2 yr. amort.)	13,059,000	3,940,000	8,342,000	34,000	1,633,000	27,008,000
Total Exogenous Cost	26,118,000	7,880,000	16,684,000	68,000	3,266,000	54,016,000

Appendix 6

Actuarial Assumptions and Data for SFAS-112 Long-Term Disability Expense

Pacific Telesis Group

FAS 112 Valuation

	FISCAL YEAR (in thousands)					
	1994	1995	1996	1997	1998	1999
PACIFIC BELL						
Liability, 1/1	94,534	105,020	116,124	127,672	139,684	152,386
Benefit Payments	(8,330)	(10,302)	(11,649)	(13,029)	(14,258)	(15,602)
Interest Cost	6,778	7,490	8,273	9,087	9,941	10,844
Additional Reserve	12,038	13,916	14,924	15,954	17,019	18,120
Liability, 12/31	105,020	116,124	127,672	139,684	152,386	165,748

Pacific Telesis Group

FAS 112 Valuation

Assumptions and Methods

The assumptions and methods used for the January 1, 1994 actuarial valuation are listed below:

Discount Rate	7.5% compounded annually
Salary Scale	4.0% (compounded annually)
Mortality	PTG Disabled Mortality Table
Expense Load	6.0% of benefit payments
Measurement Date	December 31

Trend Rate

Year	Rate
1994	13.0%
1995	13.0%
1996	10.0%
1997	9.0%
1998	8.0%
1999	7.5%
2000	7.0%
2001	6.5%
2002+	6.0%

Percent Married	60% (Wives are assumed to be three years younger than their husbands.)
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Medical Claim Rates

	Former Employee	Spouse
1994	\$9,900	\$1,600
1993	\$7,900	\$1,400

New Disabled Profile

Number	50
Average Age	37
Average Pay	\$32,000/year
Percent Male	50%
Average Net LTD Benefit	\$7,775/year

Pacific Telesis Group

FAS 112 Valuation

Plan Provisions

A brief summary of the plan provisions used for the valuation is provided below:

LTD Plan

Eligibility	Disabled for 12 months, but not eligible for pension benefits.
Benefit	50% of pay offset by social security and pension benefits, payable until age 65.

Medical Plan

Eligibility	Disabled for 12 months, but not eligible for pension benefits.
Benefit	Continuation of active medical plan until age 65.